



# The Game of Thrones and The Game of Markets

W. Ben Hunt, Ph.D.  
Chief Risk Officer, Salient  
October 2014

# Disclosures

This commentary is being provided to you by individual personnel of Salient Partners, L.P. and affiliates (“Salient”) and is provided as general information only and should not be taken as investment advice. The opinions expressed in these materials represent the personal views of the author(s) and do not necessarily represent the opinions of Salient. It is not investment research or a research recommendation, as it does not constitute substantive research or analysis. Any action that you take as a result of information contained in this document is ultimately your responsibility. Salient will not accept liability for any loss or damage, including without limitation to any loss of profit, which may arise directly or indirectly from use of or reliance on such information. Consult your investment advisor before making any investment decisions. It must be noted, that no one can accurately predict the future of the market with certainty or guarantee future investment performance. Past performance is not a guarantee of future results.

**Statements in this communication are forward-looking statements.**

The forward-looking statements and other views expressed herein are as of the date of this publication. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements, and there is no guarantee that any predictions will come to pass. The views expressed herein are subject to change at any time, due to numerous market and other factors. Salient disclaims any obligation to update publicly or revise any forward-looking statements or views expressed herein.

This information is neither an offer to sell nor a solicitation of any offer to buy any securities. Any offering or solicitation will be made only to eligible investors and pursuant to any applicable Private Placement Memorandum and other governing documents, all of which must be read in their entirety.

Salient commentary has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. Salient recommends that investors independently evaluate particular investments and strategies, and encourage investors to seek the advice of a financial advisor. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

This information is being provided solely for educational purposes and is not an offer to sell or solicitation of an offer to buy an interest in any investment fund. Any such offer or solicitation may only be made by means of a confidential private offering memorandum or prospectus relating to a particular fund and only in a manner consistent with federal and applicable state securities laws.

Salient is the trade name for Salient Partners, L.P., which together with its subsidiaries provides asset management and advisory services. Insurance products offered through Salient Insurance Agency, LLC (Texas license #1736192). Trust services provided by Salient Trust Co., LTA. Securities offered through Salient Capital, L.P., a registered broker-dealer and Member FINRA, SIPC. Each of Salient Insurance Agency, LLC, Salient Trust Co., LTA, and Salient Capital, L.P., is a subsidiary of Salient Partners, L.P.

## Game Theory: Play the Player, Not the Cards



# The Game of Thrones



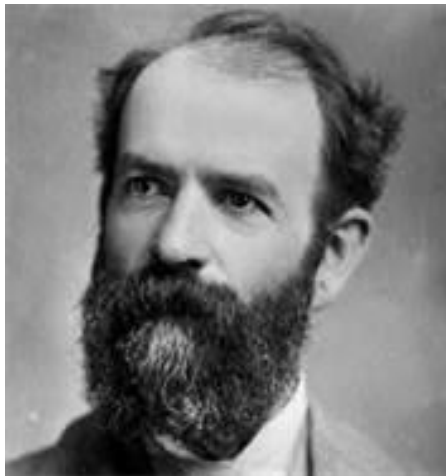
## The Lion in Winter



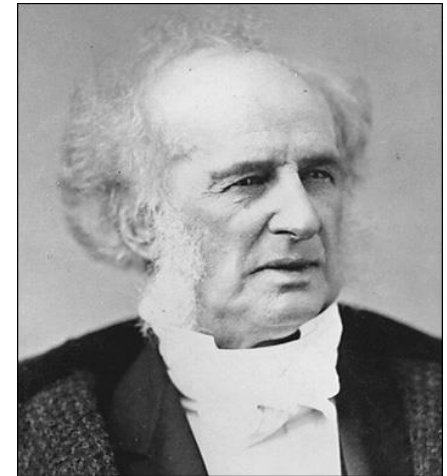
## Game Theory: Play the Player, Not the Cards



**Andrew Carnegie**



**Jay Gould**



**Cornelius  
Vanderbilt**

## What to Do When the Crystal Ball is Broken?



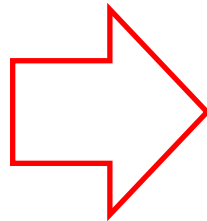
Donald Rumsfeld

“There are *known knowns*; there are things we know we know.

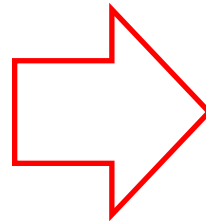
We also know there are *known unknowns*; that is to say, we know there are some things we do not know.

But there are also *unknown unknowns* – the ones we don’t know we don’t know.”

Certainty



Risk



Uncertainty

YOU ARE HERE



## History May Not Repeat Itself, But It Does Rhyme



Edward IV



Cosimo de Medici

# Source of Uncertainty is Political Fragmentation

**il Giornale**

Venerdì 9 AGOSTO 2013 Direttore ALESSANDRO SALLUSTI Anno XXXIX Numero 183 - 1.26 euro

Spread tra Btp e Bund **510** Piazza Affari **-4,64%** Consumi italiani **-2,8%**

## QUARTO REICH

*I no della Merkel e della Germania rimettono in ginocchio noi e l'Europa. Borse a picco e Monti fa il finto tonto: «Non hanno capito Draghi»*

di Alessandro Sallusti

**H**e c'è la Germania, hanno perso l'Italia, l'Europa, l'euro. Ha perso Monti, porta a spina per anni dai tedeschi i costi del processo. L'apoteosi è arrivata, come capofila della Banca Centrale, si è dovuta inchinare al valore della Merkel. Le conclusioni del decennio vanno di sicuro, in sintesi, queste: i poteri del lateranum vaticano della Banca Centrale non sono quelli attuali, cioè spinti verso gli Stati Uniti. L'Europa che vorrebbe accendere agli antipodi della Germania fare alla svelta anche le nostre nuove imposte e i sacrifici decisi tra Bruxelles e Berlino. Gli speculatori hanno subito frangente lo spread è diminuito (100 punti). Se il nostro paese è in crisi, l'Italia è non solo in crisi ma è in Europa nel Quarto Reich. Nel primo, di Reich, il socialismo è stato con le ideologie imperante di Roma, e con che mezzi negli anni due i tedeschi hanno ingaggiato gli italiani per una serie di guerre mondiali e milioni di morti non sono evidentemente bastati a quietare le mire egemoniche tedesche. Che ora si ripresentano, non più con i canoni ma con gli euro. I tedeschi rimangono una bestia, noi dobbiamo addormentarci ai rendimenti e i rendimenti di nuovo Kuno, quell'Angelo Merkel che vorrebbe rimandare anche in caso di morte.

Riguardo che non stiamo regnando. Trattiamo i nostri, indifferente di fronte alla Germania che mostra i suoi, come le crisi di Europa nella conferenza di Monaco del 1938. Non ci occupiamo di Hitler, siamo la Germania e l'Europa e ne occupiamo di fronte ai tedeschi. L'Europa è un paese in Italia, Spagna (e tra un po' anche la Francia) a dire: «ci si va, insieme all'euro e a queste condizioni non ci può stare, piuttosto meglio tornare alle nostre tradizioni ma mantenere autonomia e libertà. Bene» e noi non si può, perché la Germania è incapace, più o meno come fare il primo ministro inglese Chamberlain nel '38. Ma allora, si dice, il non successo Winston Churchill ebbe a dire: «Dovete scegliere tra la guerra e il disonore. Se ne è disonore, avrà la guerra». Deciso a non fare la stessa fine.

Come Craxi, Pierluigi Sgarbi e un altro di Francesco Forte (a pagina 8) a pagina 8

**LA CRISI VISTA DA BERLINO: I tedeschi salvatori dell'euro? Macché, l'Italia spende di più**

di Angelo Allegri  
senza titolo a Berlino

Il Reich tedesco è ben più di un mito. Nato in Germania, arriva a Londra per una banca italiana (l'Imbroschi) e nel giorno scorso ha inviato ai nostri clienti alcuni dati del Fondo Monetario internazionale che fanno da un po' di tempo in mano gli stati europei per salvare l'euro in difficoltà, che si legge in questi giorni che a pagare tutto sono i tedeschi, oggi. «L'unico conto

almeno, il paradosso è che ad assistere gli è stato mandato il rapporto al FMI sotto proprio due tra gli Stati a rischio: Italia e Spagna. Sono bene a versare al Fondo l'Idf, quelle incaricate di versare le capitali in affanno, le società proporzionalmente maggiori (l'ingegner calcolate in rapporto alla quota posseduta nella Banca centrale europea). Quanto il FMI è ben più che un ente di controllo, solo la banca tedesca la Germania. Eppure, se si ascoltano i commentari e le voci che circolano...

segue a pagina 8

**all'interno**

**TROPPIA BUROCRAZIA**  
Se il Paese dei cavalli perde i turisti cinesi  
di Gian Micallesi  
a pagina 9

**BANDINI E ANIMALI**  
Non rassegniamoci a preferire le bestie  
di Giorgio Miele  
a pagina 10

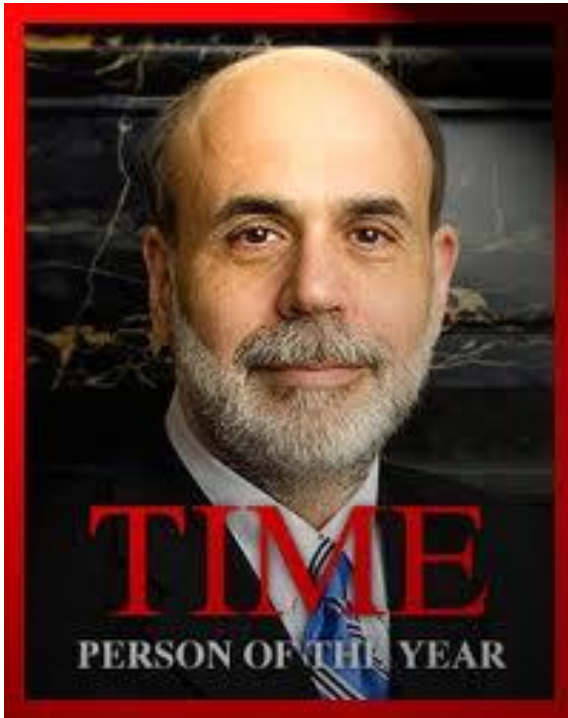
**INTERVISTA A ALBERONI**  
«Spiegatelo ai figli: mai morire d'amore»  
di Enzo Cosimi  
a pagina 11

**MERITO: DEGLI UOMINI**  
Donne, sesso forte grazie ai pregiudizi  
di A. Bernardini di Pace  
a pagina 12

**I SOCI DIFENDONO L'AD INDAGATO**  
**Mediobanca blinda Nagel**  
di Nicola Porro  
a pagina 13



# Massive Policy Experimentation With Uncertain Outcomes



“It is probably not a coincidence that the sustained recovery in U.S. equity prices began in March 2009, shortly after the FOMC's decision to greatly expand securities purchases.”

**Monetary Policy since the Onset of the Crisis**  
(Jackson Hole, August 31, 2012)

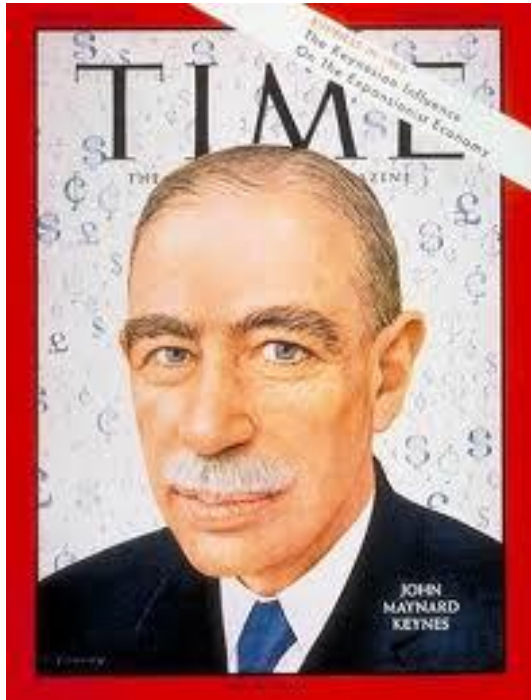


## Can't Hide Under A Rock



This is the  
business we  
have chosen.  
– Hyman Roth

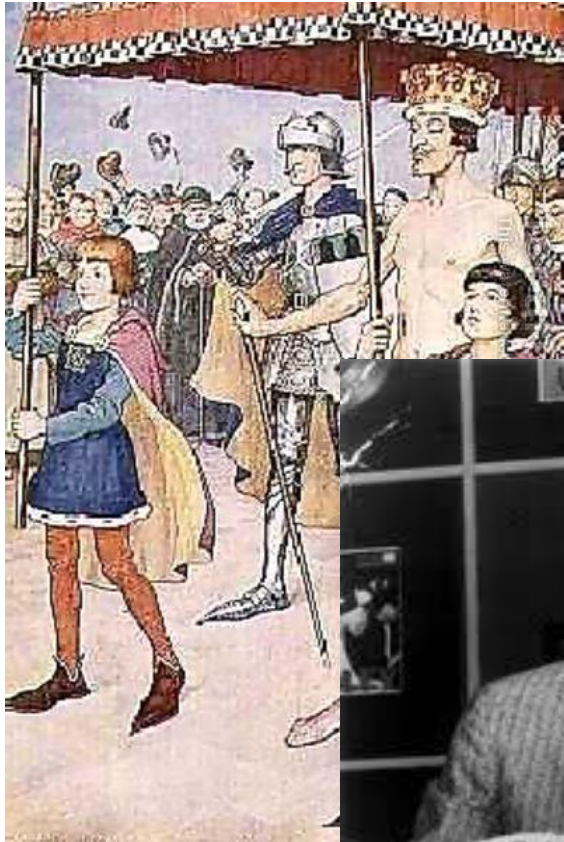
# Newspaper Beauty Contest = Common Knowledge Game



**“We have reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be. And there are some, I believe, who practice the fourth, fifth and higher degrees.”**

***The General Theory of Employment, Interest, and Money (1935)***  
**Salient** For illustrative purposes only.

# The Power of the Crowd Seeing the Crowd



## The Island of the Green-Eyed Tribe

On the Island of the Green-Eyed Tribe, blue eyes are taboo. If you have blue eyes you must get in your canoe and leave the island the next morning.

But there are no mirrors on the island, so you don't know the color of your own eyes. It is also taboo to talk or otherwise communicate with each other about blue eyes, so when you see a fellow tribe member with blue eyes, you say nothing. As a result, even though everyone knows there are blue-eyed tribe members, no one has ever left the island for this taboo.

A Missionary comes to the island and announces to everyone, "At least one of you has blue eyes."

What happens?

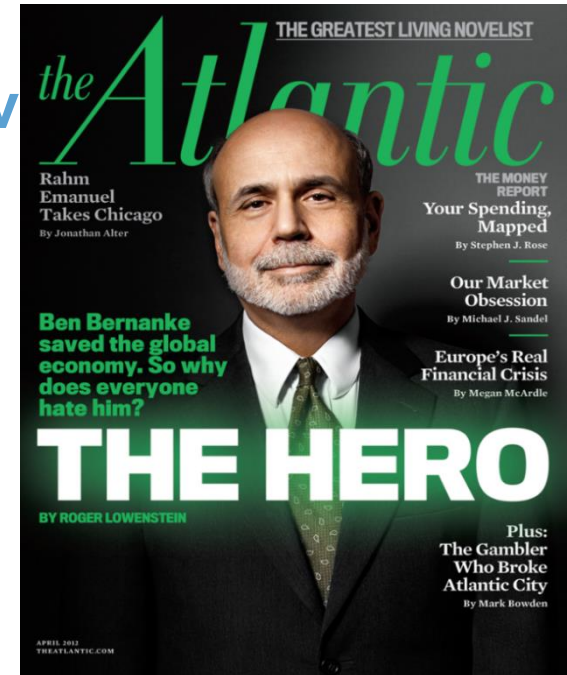
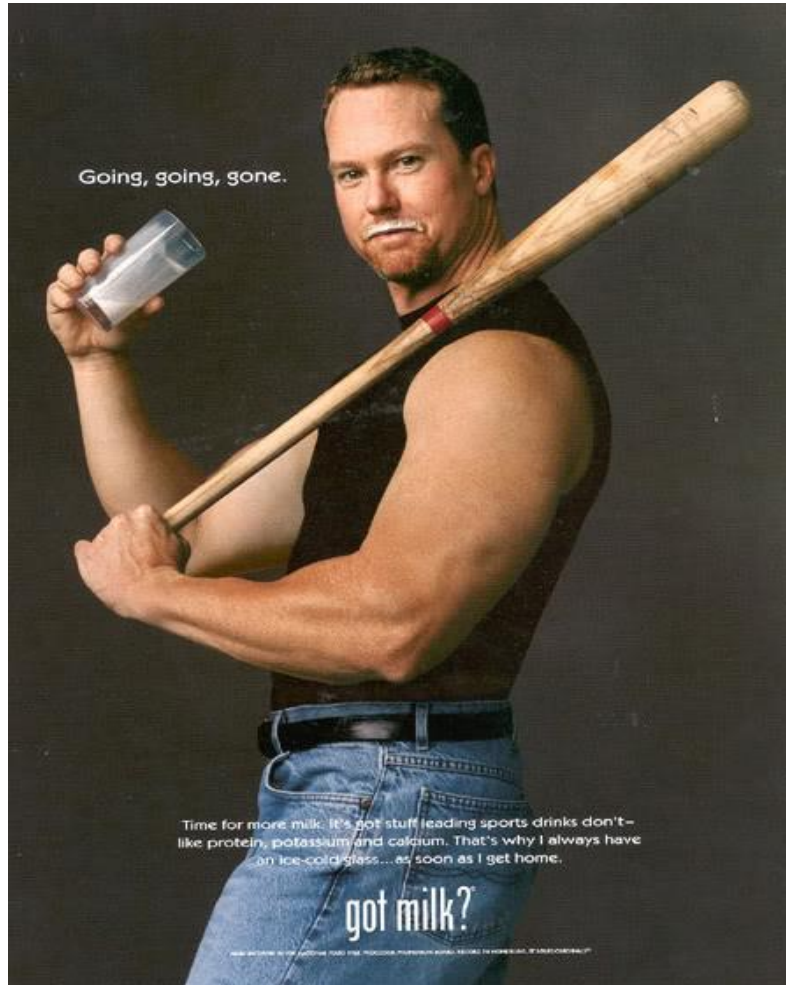


## Modern Missionaries



For illustrative purposes only.

## We are Suckers for a Good Narrative



## But Maybe We Should Be Doing More of This



## To Avoid This



Felix and Poindexter



## And This



**“Elk don’t know how many feet a horse has!”**

## What to Do When the Crystal Ball is Broken?



### Recognize Your Weakness for a Good Story

- ▶ Is the Narrative behind your decision useful to your goals ... or to theirs?

### Put Game Theory in Proper Place

- ▶ Become a better game-player for tactical investment decisions.
- ▶ Avoid game-playing for long-term, strategic investments.

### Consider New Ways of Looking at Old Narratives

- ▶ Add an informational perspective on Alpha, a dynamic perspective on Beta, and a behavioral perspective on Epsilon.
- ▶ **This is Adaptive Investing.**

## Adaptive Investing

*behavioral perspective on  
Epsilon*

Energy Traders  
Political Trades

*informational perspective on  
Alpha*

Private Equity  
MLPs

*dynamic perspective on  
Beta*

Risk Parity



W. Ben Hunt, Ph.D.

[EpsilonTheory.com](http://EpsilonTheory.com)

[bhunt@salientpartners.com](mailto:bhunt@salientpartners.com)

4265 San Felipe, 8th Floor

Houston, Texas 77027

Phone: 713.993.4675

Fax: 713.993.4698

[salientpartners.com](http://salientpartners.com)